FitchRatings

RATING ACTION COMMENTARY

# Fitch Revises LeasePlan's Outlook to Stable; Affirms at 'BBB+'

Mon 20 Sep, 2021 - 10:42 ET

Fitch Ratings - Frankfurt am Main - 20 Sep 2021: Fitch Ratings has revised the Outlook on LeasePlan Corporation N.V.'s (LeasePlan) Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR at 'BBB+' and Viability Rating (VR) at 'bbb+'. Fitch has also affirmed Lincoln Financing S.a.r.l.'s (LF) senior secured notes' long-term rating at 'BB-' and the Long-Term IDR of the notes' guarantor, Lincoln Financing Holdings Pte Limited (LFHPL), at 'BB-' and revised the Outlook to Stable from Negative.

The revision of the Outlook on LeasePlan's Long-Term IDR reflects Fitch's view that the business model held up well during the Covid-19 pandemic, with asset quality remaining sound and revenue in its core leasing activities supported by a proactive portfolio approach (including contract extensions on maturing leasing contracts). The broader economic backdrop in LeasePlan's core markets (most notably in Europe) shows signs of a sustained recovery (notwithstanding supply challenges experienced by some original equipment manufacturers, which in our view should support good demand for LeasePlan's service offering.

## KEY RATING DRIVERS

LEASEPLAN - IDRs, VR, SENIOR UNSECURED DEBT AND SUPPORT RATING

The affirmation of LeasePlan's IDRs, VR and senior debt and programme ratings reflect the company's leading position in the auto leasing sector globally, with a vehicle fleet of around 1.85 million vehicles in more than 30 countries. Our assessment also recognises LeasePlan's status as a regulated bank, prudent risk appetite and sound financial profile. This is balanced against exposure to residual value (RV) risk arising from closed-end leasing, increased earnings volatility in recent years and our expectation of a material dividend upstream to service debt raised by LF outside the regulated group.

LeasePlan's main business units are automotive leasing and associated services (Car-as-a-Service) and post-lease disposal (CarNext). CarNext was carved out in July 2021, with LeasePlan retaining a minority stake and access to the disposal channel via a long-term service agreement. LeasePlan also announced the adoption of a digitalised core leasing platform (NextGen), which will be rolled out over the coming years and should support business model resilience.

In our view, LeasePlan's RV risk exposure is well-managed, with consistent (albeit somewhat volatile) net used car sales results in recent years. Inventory write-downs have been limited, including during the pandemic and despite shut-downs of used car markets during the first wave of lock-downs. The anticipated increase in electric vehicles (EVs) could lead to increasing RV risk, but the gradual speed of introduction should allow for ongoing refinement of underlying RV models.

LeasePlan's balance sheet leverage remains elevated, with a gross debt/tangible equity ratio of around 6x at end-1H21 (end-2020: 6.7x). Net leverage has historically been stronger (end-1H21: 4.8x), as the company maintains a sizeable cash balance on balance sheet. As a bank, LeasePlan's is required to comply with prudential capital (and liquidity) requirements, which supports our capital & leverage assessment. At end-1H21, LeasePlan's common equity Tier 1 (CET1) ratio and total capital ratio stood at 15.1% (end 2020: 16.7%) and 17.3% (end 2020: 19.2%), respectively, compared with minimum requirements (including combined buffers) of 9.3% and 14.5%, respectively (6.7% and 11.9% respectively excluding combined buffers). The incremental reduction in the capital ratios between year-end 2020 and 1H21 is due to the adoption of the new regulatory default definition (effectively applied from 1 January 2021) as well as the exclusion of interim net profits (4Q20 to 1H21) for capital management purposes.

LeasePlan's funding profile is well diversified and benefits from demonstrated capital market access and relatively cheap deposit funding due to its online retail deposit franchises in Germany and the Netherlands (EUR10 billion at end-1H21). Balance sheet encumbrance is limited, with 90% of total non-equity funding (of which 40% is senior unsecured debt and

45% retail deposits) unsecured. Secured funding is limited to LeasePlan's established ABS programme (EUR2.1 billion at end-1H21). Liquidity is robust, supported by EUR5.6 billion in unencumbered cash balances at end-2020 and a EUR1.5 billion committed revolving credit facility (entirely undrawn at end-1H21).

Supported by resilient core earnings, and a notably improved net used car sales result LeasePlan's pre-tax profits recovered in 1H21 (EUR507 million pre-tax profit compared with EUR192 million in 1H20), having halved in 2020 (to EUR254 million), largely due to pandemic-related impairments and a lower but still positive net used car sales result. Supply constraints for new vehicles (partly due to the micro-chips shortage) drove up demand for pre-owned vehicles.

LeasePlan's Support Rating of '5' indicates Fitch's view that while institutional support from the company's shareholders is possible, it cannot be relied upon.

Given LeasePlan's status as a regulated and deposit-taking bank, Fitch used its Bank Rating Criteria to help inform its assessment of certain aspects of LeasePlan's standalone profile, such as operating environment (in particular, the regulatory framework), capitalisation and leverage and funding and liquidity.

LFHPL's IDR AND LF's SENIOR SECURED NOTES

The revision of the Outlook on LFHPL's Long-Term IDR to Stable mirrors the revision of the Outlook on LeasePlan's Long-Term IDR. We note that LeasePlan's ability to upstream dividends remains constrained by the ECB's temporary guidance to banks to defer dividends, but we expect dividend upstream to resume once guidance changes. At present LFHPL's Long-Term IDR and LF's bond rating remain supported by an adequate level of interest coverage, with liquidity reserves covering annual interest payments by more than 4x at end-2Q21. Our assessment is also supported by LF's requirement to maintain an interest reserve account cash balance covering coupon payments of the senior notes by at least 2.5 years.

LeasePlan continues to represent LFHPL's only significant asset. There are no cross-guarantees of debt between LF and LeasePlan, and the ratings reflect the structural subordination of LFHPL's and LF's creditors to those of LeasePlan. In Fitch's view, debt issued by LF is sufficiently isolated from LeasePlan so that failure to service it, all else being equal, would have limited implications for LeasePlan's creditworthiness. Consequently, the instrument rating is based on the standalone profile of LF and LFHPL as the issuance guarantor.

## RATING SENSITIVITIES

LEASEPLAN's IDRS, VR AND SENIOR DEBT

Factors that could, individually or collectively, lead to positive rating action/upgrade:

A sustained reduction in gross balance sheet leverage and a reduced need for continuous sizeable upstream dividends (for instance, resulting from a material reduction in LF's debt).

An upgrade of LeasePlan's Short-Term IDR would either require an upgrade of LeasePlan's Long-Term IDR or a more favourable assessment of the company's funding and liquidity score.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A material increase in RV risk, leading to sustained net losses from fleet disposals materially negatively impacting LeasePlan's earnings capabilities and profitability.

A material and sustained decline in LeasePlan's core operating leasing income, arising in particular from a permanent reduction in the vehicle fleet amid constrained demand dynamics.

A sharp increase in impairment charges on loans and receivables.

An inability to maintain its currently adequate liquidity and funding profile due to increased refinancing risks.

A reduction in capital adequacy regulatory headroom.

LEASEPLAN'S SUPPORT RATING

Fitch does not currently expect changes to LeasePlan's Support Rating.

LFHPL's IDR AND LF's SENIOR SECURED NOTES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Positive rating action would likely require the accumulation of significant additional cash within LFHPL, accompanied by the expectation of its retention, as this would reduce the dependence of debt service on LeasePlan dividends.

The ratings could also be sensitive to the addition of new liabilities or assets within LFHPL, but the impact would depend on the balance struck between increasing LFHPL's debt service obligations and diversifying its income away from reliance on LeasePlan dividends.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

LFHPL's Long-Term IDR and the notes' rating are primarily sensitive to any significant depletion of liquidity close to covenanted levels that affected its continuing ability to service its debt obligations. This would most likely be prompted by a material fall in earnings within LeasePlan, which restricted its capacity to pay dividends, or externally imposed restrictions on dividend payments beyond current restrictions imposed by the ECB. Furthermore, a downgrade of LeasePlan's Long Term IDR (implying an incrementally weaker ability to upstream dividend) could undermine LFPHL's credit profile.

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## RATING ACTIONS

| ENTITY/DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| LeasePlan Corporation N.V. | LT IDR | BBB+ Rating Outlook Stable | Affirmed | BBB+ Rating Outlook Negative |
| | ST IDR | F2 | Affirmed | F2 |
| | Viability | bbb+ | Affirmed | bbb+ |
| | Support | 5 | Affirmed | 5 |
| • senior unsecured | LT | BBB+ | Affirmed | BBB+ |
| • senior unsecured | ST | F2 | Affirmed | F2 |

**VIEW ADDITIONAL RATING DETAILS**

## FITCH RATINGS ANALYSTS

**Ben Schmidt**
Director
Primary Rating Analyst
+49 69 768076 115
ben.schmidt@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

**David Pierce**
Director
Secondary Rating Analyst
+44 20 3530 1014
david.pierce@fitchratings.com

**Christian Kuendig**
Senior Director
Secondary Rating Analyst
+44 20 3530 1399
christian.kuendig@fitchratings.com

**Dafina Dunmore**
Senior Director
Committee Chairperson
+1 312 368 3136
dafina.dunmore@fitchratings.com

## MEDIA CONTACTS

**Louisa Williams**
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

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## APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| LeasePlan Corporation N.V. | EU Issued, UK Endorsed |
| Lincoln Financing Holdings Pte. Limited | EU Issued, UK Endorsed |
| Lincoln Financing S.a.r.l | EU Issued, UK Endorsed |

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